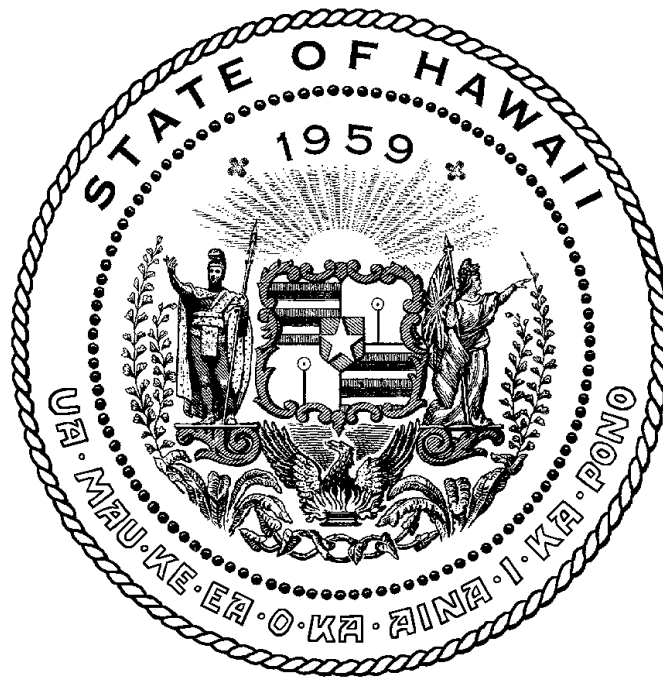


DIGEST OF TAX MEASURES

Enacted by the State of Hawaii
Eighteenth Legislature
1996 Regular Session



Prepared by the
State of Hawaii
Department of Taxation
Issued August 26, 1996

(CAUTION: This digest is issued solely as a guide and is not intended to be complete.)

**Digest of Bills
Enacted by the State of Hawaii
Eighteenth Legislature
1996 Regular Session**

The following is a digest of bills passed by the 1996 legislature. It includes only those measures which affect Hawaii's tax laws and is provided for your information. It is issued solely as a guide and is not intended to be either authoritative or complete. Copies of the bills enacted by the legislature may be obtained from the Senate and House printshops, respectively.

KEY TO ABBREVIATIONS:

S.B.	=	Senate bill
S.D.	=	Senate draft
H.B.	=	House bill
H.D.	=	House draft
C.D.	=	Conference draft
SSCR	=	Senate standing committee report
HSCR	=	House standing committee report
CCR	=	Conference committee report
SECT. AFF.	=	Section(s) of the Hawaii Revised Statutes affected by the bill's provisions
HRS	=	Hawaii Revised Statutes

DIGEST OF TAX MEASURES
Enacted by the Eighteenth Legislature
1996 Regular Session

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Enacted by the Eighteenth Legislature
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ACT 043

S. B. 2912

Relating to Contractors

SSCR 1864; SSCR 2193; HSCR 967-96; HSCR 1477-96

SECT. AFF: 444-17

Contractors licensing board given authority to revoke, suspend, or deny renewal of a contractor's license for failure to pay delinquent general excise taxes or to honor installment plan for the payment therefor.

Effective Date: April 23, 1996.

ACT 054

S. B. 2929, S.D. 1, H.D. 1

Relating to Enforcement of Criminal Provisions Under Title 14 Administered by the Department of Taxation

SSCR 1973; HSCR 1241-96

SECT. AFF: 231-1, 231-35

Clarifies criminal tax law definition of "person" to include certain individuals of taxable entities under duty to perform and who is principally responsible for performing the act in question. Imposes misdemeanor penalty for persons operating businesses without general excise and other licenses.

Effective Date: April 24, 1996.

ACT 131

H. B. 3563, H.D. 1, S.D. 1, C.D. 1

Relating to Fees Imposed by the Department of Taxation

HSCR 255-96; SSCR 2759; CCR 38

SECT. AFF: 231-25.5

Allows recovery of fees for: reissuance of refund checks (not to exceed amount of refund check), department-sponsored seminars and workshops (including educational materials), and research and reference materials in machine-readable form. Allows for a hardship waiver. Fees and hardship waiver are to be determined by rules.

Effective Date: June 12, 1996.

1996 BILLS RELATING TO TAXATION

ACT 132

H. B. 3565, H.D. 1, S.D. 1, C.D. 1

Relating to Bulk Transfers

HSCR 256-96; SSCR 2760; CCR 114

SECT. AFF: 237-43, ACT 92 1995

Clarifies application of bulk transfer law by excluding from the term "transfer" any bona fide, arm's length: (1) creation, modification or termination of a lease interest; (2) creation, modification or termination of a lien or encumbrance; or (3) transfer occurring as a result of the enforcement of a lien.

Effective Date: June 12, 1996.

ACT 133

H. B. 3567, H.D. 1, S.D. 1

Relating to the Rounding of Tax Return Entries

HSCR 539-96; SSCR 2761

SECT. AFF: 231-9

Allows Director to require rounding of tax return items to the nearest dollar.

Effective Date: June 12, 1996.

ACT 157

S. B. No. 2850, S.D. 1, H.D. 1

Relating to Voluntary Withholding of Federal and State Income Taxes From Unemployment Compensation

SSCR 1886; SSCR 2126; HSCR 987-96; HSCR 1581-96

SECT. AFF: 235-_____, 383-_____

Permits voluntary withholding of federal and state income taxes from unemployment compensation payments. State withholding rate = 5%.

Effective Date: January 1, 1997.

ACT 187

H. B. 3551, H.D. 1, S.D. 1

Relating to Income Taxation

HSCR 254-96; SSCR 2757

SECT. AFF: 235-2.3, 235-2.4, 235-2.5, 235-3, 235-55, 235-61

Picks up federal IRC changes through 12/31/95, including self-employed health insurance deduction (retroactive). Technical changes made in treatment of international transactions, cooperatives, exempt organizations, and joint filers. Picks up TEFRA provisions for auditing partnerships and S corporations, capital construction fund provision (IRC 7518), tax avoidance corporations (IRC 269A). Requires wage withholding tables to be capped at 8% rate.

Effective Date: June 17, 1996, applies to taxable years beginning after December 31, 1995.

ACT 228

H. B. 3789, H.D.2 , S.D. 2

Relating to Public Contracts

HSCR 304-96; HSCR 878-96; SSCR 2348; SSCR 2746

SECT. AFF: 103D-1002, 103-45.5

As it applies to taxes, increases preference thresholds for bidders on public works projects. State agency shall award the contract to a bidder who has filed State of Hawaii employment, general excise and income tax returns and has paid all amounts owing on such returns for four successive years prior to submitting the bid, if the bid is for 5 million or less, and for eight successive years if the bid is for more than 5 million; provided that the amount of the bid is not more than 15% higher than the amount bid by any competing contractor who has not filed or paid State of Hawaii taxes as specified.

Effective Date: June 18, 1996.

ACT 250

H. B. 3817, H.D. 1

Relating to Department of Taxation Publications

HSCR 257-96; SSCR 2948

SECT. AFF: 231- _____

Requires publication of certain reports in paper and machine-readable form, and allows the Department to charge a fee for the reports.

Effective Date: June 18, 1996.

ACT 273

H. B. 3554, H.D. 1, S.D. 1, C.D. 1

Relating to Automated Tax Systems Acquisition by the Department of Taxation

HSCR 261-96; SSCR 2758; CCR 113

SECT. AFF: ACT 218 1995

Systems replacement project; performance-based contracting.

Effective Date: June 18, 1996.

ACT 286

S. B. 3240, S.D. 2, H.D. 2, C.D. 1

Relating to State Enterprise Zones

SSCR 1875; SSCR 2171; HSCR 954-96; HSCR 1452-96; CCR 155

SECT. AFF: 209E-2, 209E-9, 209E-11

Allows additional business activities to qualify for state tax benefits and county incentives in areas designated as enterprise zones as follows: repair of ships or aircraft; education and training services; information technology design and production services; medical and health care services; and telecommunication services. Excludes businesses that act upon or process tangible personal property, such as cleaning, repair, and maintenance. Provides exceptions to certain requirements for eligibility for agricultural producers in counties with populations of 100,000 or less (to sunset 6/30/98). Changes certain requirements for eligibility.

Effective Date: June 18, 1996.

1996 BILLS RELATING TO TAXATION

ACT 314

S. B. 2913, H.D. 1, C.D. 1

Relating to Tax Liability of Contractors Contracting With the State or Counties

SSCR 1716; SSCR 2181; HSCR5 1062-96; HSCR 1478-96; CCR 94

SECT. AFF: 103-53, 237-45

State & IRS tax clearance required to enter into contracts with state or counties. Exceptions made for "small purchases" less than \$10,000 (although agencies may impose stricter requirements), emergency procurements, installment agreements, and taxes in dispute.

Progress payments required to be assigned to State and/or IRS to satisfy delinquencies. Final payment withheld until State and IRS tax clearance obtained; automatic assignment of final payment to State or IRS for failure to provide tax clearance within 6 months of completion date.

Effective Date: Applies to contracts entered into, on, or after July 3, 1996.

TABLE SHOWING EFFECT OF ACTS

Eighteenth State Legislature

1996 Regular Session

KEY:	Am	=	Amended
	N	=	New
	_____	=	Section number to be assigned in HRS Supplement

Section Number	Effect	Bill Number	Act Number
103-45.5	Am	HB 3789	228
103-53	Am	SB 2913	314
103D-1002	Am	HB 3789	228
209E-2	Am	SB 3240	286
209E-9	Am	SB 3240	286
209E-11	Am	SB 3240	286
231-_____ (1 section)	N	HB 3817	250
231-1	Am	SB 2929	054
231-9	Am	HB 3567	133
231-25.5	Am	HB 3563	131
231-35	Am	SB 2929	054
235-_____ (1 section)	N	SB 2850	157
235-2.3	Am	HB 3551	187
235-2.4	Am	HB 3551	187
235-2.5	Am	HB 3551	187
235-3	Am	HB 3551	187
235-55	Am	HB 3551	187
235-61	Am	HB 3551	187
237-43	Am	HB 3565	132
237-45	Am	SB 2913	314
383-_____ (1 section)	N	SB 2850	157
444-17	Am	SB 2912	043
ACT 092, SLH 1995	Am	HB 3565	132
ACT 218, SLH 1995	Am	HB 3554	273

DIGEST OF REVENUE PROVISIONS OF THE SELF-EMPLOYED HEALTH INSURANCE ACT (P.L. 104-7)

(NOTE: Only amendments or additions to Code sections contained in subtitle A, chapter 1 of the Internal Revenue Code are included in this Digest.)

<u>CODE §</u>	<u>DESCRIPTION OF PROVISION</u>
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NOTE: The following IRC sections are operative for Hawaii income tax purposes.

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|-----------|---|
| 162(l) | Retroactively reinstates for 1994 the deduction for 25 per cent of health insurance costs of self-employed individuals and makes the deduction permanent. Effective for taxable years beginning after December 31, 1993. |
| 162(l)(1) | Increases the deduction for health insurance costs of self-employed individuals from 25 per cent to 30 per cent. Effective for taxable years beginning after December 31, 1994. |
| 162(n) | Extends the special rule for certain group health plans to services provided after February 2, 1993, and on or before December 31, 1995. The rule provides that no deduction is allowed to an employer for any amount paid or incurred in connection with a group health plan if the plan fails to reimburse hospitals for inpatient services provided in the state of New York at the same rate that licensed commercial insurers are required to reimburse hospitals for inpatient services for individuals not covered by a group health plan. |
| 1071 | Repeals IRC section 1071, relating to the deferral of gain on sales or exchanges certified by the Federal Communications Commission (FCC) to be in furtherance of FCC policy. Thus, a sale or exchange of broadcast properties would be subject to the same tax rules applicable to all other taxpayers engaged in the sale or exchange of a business. Effective for sales and exchanges on or after January 17, 1995, and sales and exchanges before that date if the FCC tax certificate with respect to the sale or exchange is issued on or after such date, unless a binding contract for the sale or exchange was in force at the time. |
| 1033(l) | A taxpayer may not defer gain under IRC section 1033, relating to involuntary conversions, when the replacement property or stock is purchased from a related person. A related person is one who bears a relationship to the other person described in IRC section 267(b) or 707(b)(1). Effective for involuntary conversions occurring on or after February 6, 1995. |
| 1033(j) | A taxpayer may elect to treat as a tax-deferred involuntary conversion, a sale or exchange caused by the FCC's relocation of part of the microwave spectrum to be used for personal communications services. A qualifying sale or exchange must be made before January 1, 2000, and certified by the FCC as having been made in connection with the relocation of the taxpayer from the 1850-1990 MHZ spectrum. Effective for sales or exchanges after March 14, 1995. |

NOTE: The following IRC section is not operative for Hawaii income tax purposes.

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|----|---|
| 32 | A taxpayer is not eligible for the earned income credit if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds \$2,350. Effective for taxable years beginning after December 31, 1995. |
|----|---|

DIGEST OF OTHER AMENDMENTS CONTAINED IN ACT 187, SLH 1996

A. Treatment of International Transactions

1. Repeal Cross-Border Export Incentives

Sections 991 to 997, IRC, contain provisions relating to domestic international sales corporations (DISC's), which are domestic corporations that are given tax benefits for exporting outside the United States. These provisions were operative under chapter 235, HRS, but had largely been supplanted by the foreign sales corporation (FSC) rules in sections 921 to 927, IRC, which were not operative under chapter 235, HRS. The bill amended sections 235-2.3 and 235-2.4, HRS, to provide that both sets of provisions are inoperative under Hawaii law, in order to avoid the possibility of discrimination against domestic commerce.

2. Anti-Deferral Provisions

Sections 1291 to 1297, IRC, which were operative under past law, provide anti-deferral rules for passive foreign investment companies (PFICs). Those rules, which only apply to companies incorporated in a foreign country, provide that income earned by such companies is taxed to its United States shareholders when the corporation earns the income, regardless of when the income is distributed to shareholders in the form of dividends. The bill amended section 235-2.3, HRS, to make these provisions inoperative under Hawaii law, in order to avoid any argument that the law discriminates against foreign corporations.

3. Foreign Currency Gains and Losses

Sections 985 to 989, IRC, contain rules relating to taxpayers who use a currency other than the U.S. dollar, including rules to compute gain or loss upon financial transactions such as swaps, hedges, and futures. The bill amended section 235-2.3, HRS, to make these sections operative under Hawaii law, in order to ensure that Hawaii taxpayers doing business in a foreign currency are treated consistently for state and federal tax purposes.

B. Capital Construction Funds

Section 7518, IRC, along with provisions in the federal Merchant Marine Act, create tax incentives for ocean carriers and commercial fishers. The bill amended section 235-2.4, HRS, to conform to this federal provision, in order to simplify income and basis calculations for such taxpayers.

C. Conform to Federal Method of Auditing Partnerships and S Corporations

Contained within the administrative provisions of the IRC are sections 6221 to 6245, relating to entity level audits of partnerships and S corporations. These provisions were adopted by Congress in 1988 in order to facilitate audits of such passthrough entities. These provisions generally provide that:

- The entity may designate one partner or one shareholder to handle certain matters for the entity, such as agreeing to extend the statute of limitations or to negotiate a settlement for all partners in a partnership. Under present law, separate extensions must be obtained for, and separate agreements must be executed with, each individual partner or S corporation shareholder because the passthrough entities are not separately liable for tax.

1996 BILLS RELATING TO TAXATION

- The entity may apply for a refund, or the taxing authority may propose an adjustment, on behalf of the entity as a whole. Under present law, separate proposed assessments or refund claims must be prepared for all shareholders or partners.
- In general, individual shareholders or partners may not take a return filing position inconsistent from that taken by the entity unless they explicitly notify the taxing authority of the inconsistency.

D. Conform to Federal Treatment of Corporations Formed or Availed of for Tax Avoidance

Section 269A, IRC, states that if substantially all of the services of a personal service corporation are performed for another entity, and the principal purpose for the personal service corporation is the avoidance or evasion of tax, the Government may make adjustments to clearly reflect income of the corporation or any of its employee-owners. The bill amended section 235-2.3, HRS, to adopt this provision, which is designed to prevent taxpayer abuse.

E. Uniform Treatment of Cooperatives

Under section 521 and subchapter T (sections 1381 through 1388), IRC, a farmers' cooperative is treated as a passthrough entity, so that the cooperative itself is not taxed but the members of the cooperative are taxed on their share of the cooperative's income. The bill amended section 235-2.4, HRS, to conform to the IRC provisions on all cooperatives whether organized under chapter 421, HRS or not.

F. Clarify Law Applicable to Exempt Organizations

Prior to 1987, IRC section 501 was not operative in Hawaii, and the nonprofit organizations that were exempt for Hawaii purposes were listed in section 235-9, HRS. After chapter 235, HRS, was overhauled by Act 239, SLH 1987, section 235-9, HRS, applied only to organizations exclusively taxable under other laws. The second paragraph of section 235-2.4(f), HRS, which was necessary prior to 1987, is no longer meaningful and is replaced by clarifying language in this bill.

G. Clarify Treatment of Joint Return Filers When One Is a Nonresident

Section 235-55, HRS, allows a credit for income tax paid to another jurisdiction when a taxpayer is taxed by Hawaii on worldwide income and is also subject to income tax in another jurisdiction. The credit is only available to residents, but section 235-93, HRS, allows a husband and wife to elect joint return status whether or not both husband and wife are residents.

The bill amended section 235-55, HRS, to clarify that the credit is allowed to a husband and wife filing a Hawaii joint resident return (whether or not both are residents) since section 235-93, HRS, provides that they are taxed by Hawaii on worldwide income.